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In the Supreme Court of the United States

OCTOBER TERM, 1943

No. 84

DIXIE PINE PRODUCTS COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 38–39) is reported at 45 B. T. A. 286. The opinion of the Circuit Court of Appeals (R. 46–49) is reported at 134 F. 2d 273.

JURISDICTION

The decision of the Circuit Court of Appeals affirming that of the Board of Tax Appeals was entered March 5, 1943 (R. 49). A petition for a writ of certiorari was filed June 5, 1943, and granted on October 11, 1943 (R. 50). Jurisdiction of this Court is invoked under Section 240

(a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, in determining the petitioner-taxpayer's income and excess profits tax liability for 1937, the Commissioner correctly disallowed a deduction claimed under Section 23 (c) of the Revenue Act of 1936 for the amount of a state gasoline tax assessed for 1937, where the petitioner on the accrual basis was currently litigating applicability of the state taxing statute and never paid the assessment, the taxing statute being judicially determined inapplicable to petitioner in 1939.

STATUTE INVOLVED

The statute involved will be found in the Appendix, *infra*, pp. 20–22.

STATEMENT

The petitioner corporation was engaged in the business of extracting turpentine, pine oil, and resin from stumps and other waste wood (R. 36). It kept its books and filed its income tax returns under the accrual system of accounting (R. 38).

The Mississippi state gasoline tax statute (General Laws of Mississippi (1936), c. 162, Section 5 (a)) defined "gasoline" to include liquid fuels (R. 36)—

> which are used or usable in propelling motor vehicles * * * including liquids

> ordinarily, practically and commercially usable in internal combustion engines for the generation of power, and all distillates of, and condensates from petroleum * * *.

A quantity of solvent derived from petroleum products was used by the petitioner in its extraction process. In 1936 the Assistant Motor Vehicle Commissioner of Mississippi, contending that this solvent was "usable" in the operation of motor vehicles, assessed the tax on the solvent received and used by the petitioner in that year. The petitioner paid the tax, as did other companies engaged in a similar business. (R. 36.)

On August 6, 1936, however, the petitioner filed a bill of complaint in the state Chancery Court, alleging that the nature of the solvent and the use to which it was put did not fall within the state taxing statute, and asking for temporary and permanent injunctions against the future collection of the tax. A demurrer to the bill was sustained. (R. 36–37.) The petitioner thereupon appealed to the Supreme Court of Mississippi, and on January 25, 1937, that court reversed the decree of the lower court in sustaining the demurrer and remanded the cause. *Dixie Pine Products Co.* v. *Dyer*, 178 Miss. 227. (R. 37.)

The petitioner, after the date of this decision, denied that it owed, and ceased to pay, gasoline tax on the solvent used by it. The Motor Vehicle Commissioner continued to assess and demand

payment of the tax throughout 1937. He advised the petitioner then that he was uncertain whether the tax was due for the use of the solvent and that the determination of liability was then dependent upon the final decisions of the court. Other concerns using solvent in a similar process, with one exception, paid the gasoline tax assessed in 1937. (R. 37.) However, the record does not disclose whether there were many such concerns in Mississippi, nor the amounts paid by them.

On May 15, 1937, the Motor Vehicle Commissioner filed an answer to the taxpayer's bill of complaint. On December 21, 1938, the Mississippi Chancery Court, upon an agreed statement of facts, rendered its final decree perpetually enjoining the Motor Vehicle Commissioner from assessing gasoline tax on the solvent used by taxpayer. (R. 38.) That decree was affirmed by the Supreme Court of Mississippi on October 23, 1939. *Dyer* v. *Dixie Pine Products Co.*, 186 Miss. 567.

The petitioner's attorneys, by letter dated in December 1937, directed that entries be made in its books accruing the 1937 gasoline taxes, which it was then contesting and which it never paid. The entries were made, as of December 31, 1937, at some time between January 1 and March 15, 1938, in the course of closing and auditing the 1937 books. The amount of the tax thus "accrued" for 1937 was $20,839.38 and this amount

was deducted by petitioner on its income-tax return for 1937. The amount of $20,839.38 was reported as income in petitioner's 1938 tax return. (R. 38.)

The Commissioner determined that the 1937 state gasoline taxes were not deductible from income of that year. The Board of Tax Appeals sustained the determination (R. 39) and its decision was in turn affirmed by the court below (R. 46–49).

SUMMARY OF ARGUMENT

1. Petitioner seeks to deduct in 1937 the Mississippi gasoline taxes which it was then vigorously contesting, which it never paid, and which were ultimately held by the Supreme Court of Mississippi to be inapplicable to petitioner. Were petitioner on the cash basis of accounting, it is undisputed that it could not deduct such taxes from its gross income. It claims the deduction only because, being on the accrual basis, it contends that the gasoline taxes "accrued" in 1937. But the terms "accrual" and "accrued" have acquired a meaning of art in tax law, and it has become firmly established that a tax may be accrued for income tax purposes only when "all the events" have occurred "which fix the amount of the tax and determine the liability of the taxpayer to pay it." *United States* v. *Anderson*, 269 U. S. 422, 441. This principle has been applied in a wide variety of cases, both in this Court and

the lower courts. Since the Mississippi tax herein was being vigorously challenged by petitioner in 1937, it is plain that "all the events" had not occurred during 1937, for the dominant event was the outcome of petitioner's litigation with the State, which did not happen until after 1937. See *Lucas* v. *American Code Co.*, 280 U. S. 445; *United States* v. *Safety Car Heating Co.*, 297 U. S. 88, 93–94.

2. In the alternative, wholly apart from principles of accrual accounting, the Government's position here may be sustained by reliance upon such cases as *Inland Products Co.* v. *Blair*, 31 F. 2d 867 (C. C. A. 4), which are discussed in Point II, *infra*, and which indicate that in certain circumstances the Commissioner of Internal Revenue is justified in requiring a taxpayer to correct its return for a prior year which has not yet been barred by limitations.

ARGUMENT

I

THE STATE GASOLINE ASSESSMENT WAS NOT AN ALLOWABLE DEDUCTION IN 1937 BECAUSE IT WAS NOT A PROPERLY ACCRUED LIABILITY OF TE TAX LEAR

Section 23 (c) of the Revenue Act of 1936 (Appendix, *infra*), under which this case arises, allows deduction for taxes "paid or accrued" within the taxable year. The tax period here involved is the calendar year 1937. Neither during that year nor at any other time did petitioner

pay any of the Mississippi gasoline taxes which it now claims as deduction. In 1936 it instituted injunction proceedings against future collections, denying all liability on the ground that the state taxing statute was not applicable to the solvent used in its operations. That contention was ultimately upheld by the Supreme Court of Mississippi in 1939.

If petitioner had kept its books on the cash basis of accounting, there is no question that it would not be entitled to deduct the gasoline taxes which it never paid; for it is settled that a taxpayer on the cash basis may take deductions only with respect to expenditures actually made during the tax year. *Helvering* v. *Price*, 309 U. S. 409. A taxpayer on the accrual basis, however, may deduct in advance of actual payment, if the item has become a properly accrued liability within the meaning of the Federal revenue law. Cf. *United States* v. *Anderson*, 269 U. S. 422; *United States* v. *American Can Co.*, 280 U. S. 412. The taxpayer herein maintained its accounts on the accrual system, but we contend, as held by the court below, that the gasoline taxes were not properly accruable for federal income tax purposes in 1937.

Although the revenue law does not define what constitutes an "accrued" liability,[1] there exists a

[1] Section 48 (c) of the Revenue Act of 1936 (Appendix, *infra*) merely states that the term "paid or accrued" shall be construed according to the method of accounting upon the basis of which the taxpayer's net income is computed for federal tax purposes, i. e., upon the cash or the accrual basis.

very considerable body of decisions interpreting the tax-meaning of the word "accrued." In *United States* v. *Anderson, supra,* which involved a deduction for munitions tax, this Court characterized "accrual" of a tax liability as the time when (269 U. S. 422, 441)—

> all the events * * * occur which fix the amount of the tax and determine the liability of the taxpayer to pay it.

It is now almost uniformly accepted doctrine that income and expense items "accrue" to a taxpayer, *only* when there arises in him a fixed and unconditional right to receive or a fixed and unconditional obligation to pay; so long as the right to receive or the obligation to pay is uncertain or contingent, the item has not "accrued". The uncertainty must be resolved; the determining "event" must be awaited. These principles have been acknowledged in cases involving a wide variety of income and expense items.[2] And where

[2] The following are but random examples taken from a vast body of case law: *United States* v. *Safety Car Heating Co.*, 297 U. S. 88; *Spring City Co.* v. *Commissioner*, 292 U. S. 182; *Brown* v. *Helvering*, 291 U. S. 193; *Burnet* v. *Huff*, 288 U. S. 136; *North American Oil* v. *Burnet*, 286 U. S. 417; *Lucas* v. *Ox Fibre Brush Co.*, 281 U. S. 115; *Lucas* v. *American Code Co.*, 280 U. S. 445; *Triplex Safety Glass Co. of North American* v. *Latchum*, 131 F. 2d 1023 (C. C. A. 3d); *London-Butte Gold M. Co.* v. *Commissioner*, 116 F. 2d 478 (C. C. A. 10th); *H. Liebes & Co.* v. *Commissioner*, 90 F. 2d 932 (C. C. A. 9th); *Commissioner* v. *Brooklyn R. S. Corp.*, 79 F. 2d 833 (C. C. A. 2d); *Umsted* v. *Commissioner*, 72 F. 2d 328 (C. C. A. 8th); *Commissioner* v. *Southeastern Ex-*

a taxpayer denies or contests an alleged obligation, liability therefor is not "unconditional" until he ceases to deny it or the issue is authoritatively decided against him. The resolving "event" in such case is the admission or the determination of liability; the item "accrues" at that time and not before. *Lucas* v. *American Code Co.*, 280 U. S. 445. Cf. *Lewellyn* v. *Elec. Reduction Co.*, 275 U. S. 243.

Thus, in *Lucas* v. *American Code Co., supra,* this Court held, *inter alia,* that a taxpayer which had committed a breach of contract in 1919 could not accrue any deduction in 1919 on account of liability for the breach where it "strenuously contested" that liability, and where judgment for that liability was not entered against it until 1922. 280 U. S. 445, 450–451.

If these principles are applied here, it is apparent that the petitioner had no "accrued" liability in 1937 for the Mississippi gasoline tax, even if it had not been thereafter determined that the state statute was inapplicable. The suit which petitioner had instituted and was currently prosecuting to test the applicability of the taxing statute was a denial of the "liability" to pay; until disposition of that cause, there was always the possibility that petitioner might never have to discharge the purported obligation. The uncer-

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press Co., 56 F. 2d 600 (C. C. A. 5th); *Kentucky & Indiana T. R. Co.* v. *Commissioner*, 54 F. 2d 738 (C. C. A. 6th); *Central Power Co.* v. *United States*, 44 F. Supp. 596 (C. Cls.).

tainty was finally resolved in October of 1939, when the Mississippi Chancery Court's decree of perpetual injunction against assessing the tax on use by petitioner of its solvent was affirmed by the Supreme Court of that state (R. 38). Petitioner's liability for the state gasoline tax was decidedly not a "fixed and unconditional obligation to pay" during the tax year 1937 nor then recognized by it to be such.[3] Accordingly, we submit, the amount of the assessment was not an "accrued" item of expense of that year. *Brown* v. *Helvering*, 291 U. S. 193; *Lucas* v. *American Code Co.*, 280 U. S. 445.

There have been departures from these principles in several cases in the lower courts, which presumably furnished the basis for certiorari in this case. *Davies' Estate* v. *Commissioner*, 126 F. 2d 294 (C. C. A. 6th), certiorari denied, 317 U. S. 640; *J. A. Dougherty's Sons* v. *Commissioner*, 121 F. 2d 700 (C. C. A. 3d). See also *Helvering* v. *Cannon Valley Milling Co.*, 129 F. 2d 642, 644, fn. 1 (C. C. A. 8th); *Commissioner* v. *Central United Nat. Bank*, 99 F. 2d 568 (C. C. A. 6th). But cf. *Ben Bimberg & Co.* v. *Helvering*, 126 F. 2d 412 (C. C. A. 2d), certiorari denied, 317 U. S. 641.

[3] Indeed, during 1937, the Supreme Court of Mississippi had ruled that the demurrer to petitioner's complaint had been improperly sustained, and, as the court below in the instant case observed (R. 48), petitioner had thus "won the first round of litigation in the Supreme Court of Mississippi."

The deduction claims in the *Dougherty* case, *supra*, were founded on a liquor floor tax statute of the State of Pennsylvania which was declared unconstitutional subsequent to the three tax years for which the deductions were sought. During each of those years, the taxpayer filed information returns with the state covering the amount of liquors on hand subject to the state levy and regularly "accrued" on its books the amount of each year's assessments, but never paid any part of the purported tax. The state taxing authorities, after having granted successive extensions of time for payment, ultimately brought suit against the taxpayer to test the validity of the taxing statute. The taxpayer asserted the defense of unconstitutionality. Before the action came on for hearing, however, the statute was declared invalid in another suit to which the taxpayer was not a party.

The Circuit Court of Appeals for the Third Circuit, in ruling that the assessments were allowable deductions in the years claimed, reasoned that prior to the determination of the taxing statute's invalidity, it had (p. 703) "imposed * * * liability" upon the taxpayer, and therefore the amounts assessed thereunder in the years preceding adjudication of invalidity had "accrued" for federal tax purposes. The court said (p. 700) that it had lately been recognized that the consequences of action taken in obedience to

the requirements of a statute which subsequently is declared unconstitutional are to be appraised in the light of the compulsion exerted by the statute prior to its determined invalidity. Principal reliance was placed on this Court's language in *Chicot County Dist.* v. *Bank,* 308 U. S. 371. In that case, this Court had said (p. 374):

> The actual existence of a statute, prior to such a determination [of invalidity], is an operative fact and may have consequences which cannot justly be ignored.

But the *Chicot County* case was not a tax case and it was misapplied by the Third Circuit in the *Dougherty* case. The question is not whether an invalid statute is "an operative fact," but rather whether liability under such a statute which is being contested may be "accrued" under the revenue acts. The fact that liability is being contested, whether under a statute, contract, or otherwise, is the significant consideration that prevents it from being accrued. Indeed, the fact that the statute is later determined to be invalid is irrelevant; for even if the statute were held to be valid, the item could not be accrued for tax purposes while it is still in contest, although it would be proper to accrue it in the year the statute is sustained.[4]

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[4] *Davies' Estate* v. *Commissioner,* 126 F. 2d 294 (C. C. A. 6th), certiorari denied, 317 U. S. 640, which approved the reasoning of the *Dougherty* case, similarly rested upon untenable grounds. The taxpayer in the *Davies' Estate* case claimed a deduction for 1935 on account of processing taxes,

The rule of nonaccrual of contested liabilities is good accounting principle and sound tax law; there is no reason to depart therefrom merely because the liability in question is asserted on sovereign authority. Certainly the Revenue Act itself affords no basis for such a distinction. It may be that a tax liability "accrues", by reason of the provisional validity or asserted applicability of the foundation statute, to a taxpayer who consistently recognizes liability thereunder. But if he contests liability under the statute, there is no justification for giving him a deduction that is not available to taxpayers on the cash basis. The purpose of permitting taxpayers to deduct amounts not yet paid out, by means of the accrual system of accounting, is to provide a more accurate measure of the taxpayer's real income for the tax year. But the integrity of that system can be maintained only by permitting deductions for liabilities that have become fixed by law. Where such liabilities are in dispute, they should be accruable only when the dispute is resolved, and not before.

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notwithstanding the fact that he had obtained an injunction against the collection of such taxes which were subsequently held unconstitutional on January 6, 1936, in *United States* v. *Butler*, 297 U. S. 1, and were thus never paid. The decision of the Sixth Circuit, permitting the accrual of such processing taxes in 1935, was contrary to established principles of accrual accounting under the revenue acts, and its unsoundness is underscored by the illogical distinction drawn between the December 1935 processing taxes on which no returns had been filed and the 1935 processing taxes prior to December.

II

IN ANY EVENT, PETITIONER'S RETURN MAY BE CORRECTED TO REFLECT THE ACTUAL NONEXISTENCE OF LIABILITY FOR THE STATE TAX

In Point I we contended that, regardless of the ultimate outcome in 1939 of petitioner's litigation with the state of Mississippi, it could not deduct the gasoline tax in 1937, because that tax liability, like any other contested liability, could not properly be "accrued" in 1937. However, if the Court should not accept that position, we contend here, in the alternative, that the Commissioner was nevertheless right in correcting petitioner's return to reflect the *actual* nonexistence of liability in 1937.

The power of the Commissioner to correct returns in the light of subsequent events which disclose the true state of affairs during the tax year, so long as it is not barred by the statute of limitations, is indicated by a rather substantial body of decisions in the lower courts and administrative practice. Prominent among those decisions is *Inland Products Co.* v. *Blair*, 31 F. 2d 867 (C. C. A. 4th), where the taxpayer voluntarily paid a federal soft drink excise tax in connection with its product, sweet cider, and deducted the tax. In a subsequent tax year it was judicially determined, however, that the Treasury Regulations, which interpreted the taxing statute to impose the levy on cider were void because, as here, the statute did not apply to the taxpayer's

product.[5] The amount paid as tax was accordingly refunded. The court said of the situation (p. 868) that the—

> collector * * * had no right to demand, and the taxpayer was not required to pay, any tax upon cider, and the payments in question were not payments of tax, but payments made by mistake * * *.

Elimination of the deduction was therefore correction of the error, and placed both Government and taxpayer, the court said (p. 868), "exactly where they would have been, if it [the mistake] had not occurred."

As in the case at bar, the taxpayer in the *Inland Products Co.* case sought to retain the benefit of the deduction it had taken and to "compensate" by returning the refund as income of the refund period. The principal distinction between the *Inland Products Co.* case and this one lies in the fact that the taxpayer there voluntarily paid the tax and received a refund, whereas here no payment and refund, voluntary or otherwise, are involved. The petitioner at bar merely made a book entry of the gasoline tax as an "accrued" expense of 1937 while strenuously denying that it owed any tax, and included the accrual as "recovery" in its 1938 return when its attitude to-

[5] The taxpayer in the *Inland Products Co.* case was apparently not a participant in the suits which determined the inapplicability of the taxing statute to sweet cider. See *Casey* v. *Sterling Cider Co.*, 294 Fed. 426 (C. C. A. 1st); *Monroe Cider Vinegar & Fruit Co.* v. *Riordon*, 280 Fed. 624 (C. C. A. 2d).

ward liability was proved correct. But that distinction would seem only to present the instant situation as an even stronger case for correction, since the error here was without any tangible consequence whatever other than its effect upon the federal income taxes here involved.

The result reached in the *Inland Products Co.* case was confirmed by the Court of Claims when the taxpayer subsequently took the same cause there on allegation that the decision by the Fourth Circuit was void for want of jurisdiction in that court. *Bohemian Breweries* v. *United States*, 27 F. Supp. 588. Passing anew upon the merits of the Commissioner's disallowance of the deduction, the Court of Claims said, as had the Fourth Circuit, that the excise tax paid was not legally due and (pp. 591–592) that—

> So long as a case involving the audit and determination of the correct tax liability of a taxpayer is open and under consideration by the Commissioner of Internal Revenue, it is his duty correctly to determine the income of the taxpayer and deductions to which the taxpayer is entitled.

It is when correction of the earlier year return is barred by the statute of limitations, the Court of Claims said (p. 592), that to prevent tax escape, the refund is to be included as "income" of the later year. But (p. 592)—

> Wherever it is possible to do so, the taxing statutes require that the items of income subject to tax and the deductions to which the taxpayer is legally entitled for the

> years under consideration be correctly and legally determined by the Commissioner in his final decision, notwithstanding such decision may be made several years after the returns for the particular years involved were filed.

There is, of course, no problem of limitations in the case at bar.[6]

The Circuit Court of Appeals for the First Circuit in *Leach* v. *Commissioner*, 50 F. 2d 371, likewise held that deletion of the deduction rather than inclusion in subsequent income was the proper procedure where a taxpayer on the cash basis recovered a judgment of refund in a later year for overpayment of an estate tax in an earlier year which was still "open." The same approach has also been taken by the Circuit Court of Appeals for the Second Circuit toward tax treatment of the recovery of illegally collected income taxes from an estate. *Bergan* v. *Commissioner*, 80 F. 2d 89. Cf. *Ben Bimberg & Co.* v. *Helvering*, 126 F. 2d 412 (C. C. A. 2d), certiorari denied, 317 U. S. 641; *Uncasville Mfg. Co.* v. *Commissioner*, 55 F. 2d 893, 895 (C. C. A. 2d), certiorari denied, 286 U. S. 545; *Acme Coal Co.* v. *United States*, 44 F. 2d 95, 100 (C. Cls.). There are also numerous decisions by the Board of Tax Appeals applying this rule, not only to "other

[6] Petitioner's 1937 return in which it claimed this deduction was presumably filed on or before March 15, 1938. The date of the deficiency notice was April 15, 1940 (R. 7), well within the limitation period. See Revenue Act of 1936, Section 275, Appendix, *infra*.

tax" deductions upon which there was never liability in fact but to other classes of factually nonexistent liabilities as well; and no distinction has been made between accruals and payments. See *E. B. Elliott Co.* v. *Commissioner,* 45 B. T. A. 82, for a representative list of such cases. For rulings indicating administrative practice in accord with these principles, see I. T. 1984, III-1 Cum. Bull. 140; I. T. 2500, VIII–2 Cum. Bull. 103; I. T. 2934, XIV–2 Cum. Bull. 63.

The maintenance of the statutory annual system of accounting, as illustrated by *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, is, of course, of great importance to the Government in the administration of the income tax laws, and we do not wish to suggest any rule here that would weaken that principle. But there is no necessary conflict between that principle and the right of the Commissioner to correct the taxpayer's return to reflect the fact that the liability upon which a deduction claim is based was actually nonexistent. Thus, it has never been thought that the principle of the annual system prevents the Commissioner within the period of limitations from correcting "errors" in the taxpayer's return, such as errors of computation or omission. And it is not unreasonable to classify with such errors a mistaken belief in the existence of a liability which is subsequently shown to be nonexistent.[7]

[7] The point may be illustrated by the following example. Suppose that a taxpayer receives a bill for $1,000 for services

CONCLUSION

Since liability for the gasoline taxes was being vigorously contested by petitioner in 1937 it should not be allowed to accrue those taxes as a deduction for that year. In the alternative, apart from the principles of accrual accounting, the same result may be reached by applying the decisions permitting the Commissioner to correct an erroneous return for an earlier year that is still open. Upon either theory, the judgment below should be affirmed. The first theory, however, is based upon principles that have long been firmly established by decisions of this court, and offers a more satisfactory solution.

Respectfully submitted.

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rendered to him and that he accepts the bill as correct and accrues the item. After the tax year closes the creditor, discovering that he has erroneously overcharged the taxpayer $200, voluntarily corrects the bill. It would seem clear that so long as the tax year is not barred by limitations, the Commissioner should be able to require the taxpayer to correct its return.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(c) *Taxes generally.*—Taxes paid or accrued within the taxable year, * * * [with exceptions not material here].

* * * * *

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

SEC. 43. PERIOD FOR WHICH DEDUCTIONS AND CREDITS TAKEN.

The deductions and credits (other than the dividends paid credit provided in section 27) provided for in this title shall be taken for the taxable year in which "paid or accrued" or "paid or incurred", dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *

* * * * * *

SEC. 48. DEFINITIONS.

When used in this title—

* * * * * *

(c) *Paid, Incurred, Accrued.*—The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under this Part.

* * * * * *

SEC. 272. PROCEDURE IN GENERAL.

* * * * * *

(g) *Jurisdiction Over Other Taxable Years.*—The Board in redetermining a deficiency in respect of any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid.

* * * * * *

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) *General Rule.*—The amount of income taxes imposed by this title shall be

assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

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U. S. GOVERNMENT PRINTING OFFICE: 1943

SUPREME COURT OF THE UNITED STATES.

No. 84.—October Term, 1943.

Dixie Pine Products Company, Petitioner, vs. Commissioner of Internal Revenue.	On Petition for Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

[January 3, 1944.]

Mr. Justice Roberts delivered the opinion of the Court.

The question presented concerns the propriety of the respondent's disallowance of a deduction from income which petitioner took in its federal income tax return for 1937.

In 1936 the Mississippi taxing authorities declared that a solvent used by petitioner in its business was gasoline within the meaning of a state law defining gasoline and laying a tax upon its receipt and use. Accordingly a tax was assessed against the petitioner with respect to the receipt and use of the solvent in 1936. Petitioner paid the tax, and, in the same year, brought suit against the Motor Vehicle Commissioner of Mississippi alleging that the solvent was not within the comprehension of the state law and that the Commissioner should be temporarily and permanently enjoined from future collections of tax in respect of it. The Commissioner's demurrer to the complaint was sustained but, on appeal, the Supreme Court of Mississippi decided that, on the pleadings, the solvent was not within the definition of gasoline contained in the state statute. After this decision petitioner denied that it owed, and ceased and refused to pay, any gasoline tax on solvent used by it.

In December 1937, on advice of counsel, petitioner (which kept its books and filed its federal income tax returns on the accrual basis) made book entries accruing gasoline tax assessed by the Motor Vehicle Commissioner in 1937. The actual accrual entries were made sometime between January 1 and March 15, 1938, as of December 31, 1937, in the amount of approximately $21,000, and petitioner deducted this amount from income in making its

1937 federal income tax return, although the sum had not been, and never was, paid.

In December 1938 petitioner and the Attorney General of Mississippi filed an agreed statement of facts in the state court suit, and, in the same month, the trial judge entered a final decree perpetually enjoining the Motor Vehicle Commissioner from assessing gasoline tax on the solvent used by petitioner. This decree was subsequently affirmed by the Supreme Court of Mississippi. In its 1938 federal income tax return petitioner, by way of compensating entry, included the sum of $21,000 as income and as a recovery, in view of the Mississippi trial court's decree of December 1938.

The sole question is whether the Commissioner was right in disallowing the deduction for the tax year 1937. The Board of Tax Appeals held that he was,[1] and the court below affirmed its decision.[2] We took the case because of a conceded conflict in principle with decisions in other circuits.[3]

Section 23(c) of the Revenue Act of 1936[4] permits the deduction from gross income of taxes "paid or accrued within the taxable year". Sections 41, 42, and 43 make provision for tax accounting on the accrual basis, where the taxpayer keeps his books on that principle, provided his method clearly reflects his income in any taxable year.

The provisions of the Revenue Act of 1936 worked no significant change over earlier Acts respecting the permissible basis of calculating annual taxable income. The applicable principles of accounting on the accrual basis had been adduced and applied by the Board of Tax Appeals in numerous decisions.[5] It has never been questioned that a taxpayer who accounts on the accrual basis may, and should, deduct from gross income a liability which really accrues in the taxable year.[6] It has long been held

[1] 45 B. T. A. 286.

[2] 134 F. 2d 273.

[3] Commissioner *v.* Central United National Bank, 99 F. 2d 568; J. A. Dougherty's Sons *v.* Commissioner, 121 F. 2d 700; Davies' Estate *v.* Commissioner, 126 F. 2d 294.

[4] 49 Stat. 1648, 1659.

[5] See Lucas *v.* American Code Co., 280 U. S. 445, Notes 1 and 3, pp. 450, 452.

[6] United States *v.* Anderson, 269 U. S. 422; American National Co. *v.* United States, 274 U. S. 99; Niles Bement Pond Co. *v.* United States, 281 U. S. 357; Aluminum Castings Co. *v.* Routzahn, 282 U. S. 92; cf. Continental Tire and Lumber Co. *v.* United States, 286 U. S. 290.

that, in order truly to reflect the income of a given year, all the events must occur in that year which fix the amount and the fact of the taxpayer's liability for items of indebtedness deducted though not paid;[7] and this cannot be the case where the liability is contingent and is contested by the taxpayer.[8] Here the taxpayer was strenuously contesting liability in the courts and, at the same time, deducting the amount of the tax, on the theory that the state's exaction constituted a fixed and certain liability. This it could not do. It must, in the circumstances, await the event of the state court litigation and might claim a deduction only for the taxable year in which its liability for the tax was finally adjudicated.[9]

To this effect are the decisions of the Board of Tax Appeals in numerous cases, and the instant decision was in line with earlier rulings as to proper tax accounting practice. Since the Board applied the correct rule of law, its determination that the item in question was not properly deducted on the accrual basis is entitled to the finality indicated by *Dobson* v. *Helvering*, 320 U. S. —. The court below properly refused to disturb the Board's determination.

Affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.

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[7] United States v. Anderson, *supra*, 441.

[8] Lucas v. American Code Co., *supra*, 450, 451.

[9] Cf. Brown v. Helvering, 291 U. S. 183.